STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	)	
	)	
Petition for approval of an Alternative Rate Regulation	)	Docket No. 10-0527
Plan pursuant to Section 9-244 of the Public Utilities Act	)	

DIRECT TESTIMONY OF MICHAEL L. BROSCH

ON BEHALF OF

PEOPLE OF THE STATE OF ILLINOIS

DATED NOVEMBER 9, 2010

DIRECT TESTIMONY OF MICHAEL L. BROSCH

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I. INTRODUCTION / SUMMARY

Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is PO Box 481934, Kansas City, Missouri 64148-1934.

Q. By whom are you employed and in what capacity?

A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to regulatory projects for utility regulation clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses, utility reorganization analyses and focused investigations related to utility operations and ratemaking issues.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of the People of the State of Illinois represented by the Attorney General, ("Attorney General" or "AG").

Q. Will you summarize your educational background and professional experience in the field of utility regulation?

A. Yes. AG Exhibit No. 1.1 is a summary of my education and professional qualifications. I have testified before utility regulatory agencies in Arizona, Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Texas, Utah, Washington, and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities. A listing of my previous testimonies in utility regulatory proceedings is set forth in AG Exhibit No. 1.2. In Illinois, I have testified in several major proceedings before the Illinois Commerce Commission ("the Commission"). These include Peoples Gas rate cases in Docket Nos. 90-0007 and 07-0241, North Shore Gas Company Docket No. 92-0242, Illinois Bell Telephone Company in Docket Nos. 92-0448 and 92-0239, ComEd's rate case Docket No. 07-0566 and Ameren Illinois Utilities Docket Nos. 07-0585 through 07-0590. I also testified in ComEd Docket No. 09-0263 involving the Advanced Metering Infrastructure Pilot Program and Associated Tariffs and have submitted Direct Testimony in the pending ComEd rate case, Docket No. 10-0467.

Q. Have you previously addressed alternative regulation issues in energy utility regulatory proceedings in Illinois and in other states?

A. Yes, although most of these efforts have been advisory to regulatory counsel, where there is no publicly available testimony or other written work product. I formally addressed alternative regulation in Illinois in Docket No. 92-0448 involving Illinois Bell Telephone Company in Direct Testimony submitted on behalf of CUB. This is the only comprehensive alternative regulation plan I have addressed in Illinois, although I have also testified in several Illinois cases in response to piecemeal ratemaking tariffs designed to selectively charge consumers for elements of the revenue requirement, but not replace traditional regulation with alternative approaches.

I have also sponsored testimony in Arizona, Iowa, Kansas, Oklahoma and Washington in proceedings where comprehensive alternative regulation plans were under consideration. I have also assisted Utilitech clients in Hawaii and Texas in the design of alternative regulation plans involving energy utilities in those states, but this work has not involved publicly filed testimony.

Q. What is the purpose of your testimony in this docket?

A. My testimony is responsive to the Rate ACEP Accelerated Customer Enhancements Pilot tariff and associated regulatory proposals of Commonwealth Edison Company ("ComEd"), filed as part of its "Petition for approval of an Alternative Rate Regulation Plan pursuant to Section 9-244 of the Public Utilities Act." I will describe alternative regulation and how it has been employed in other jurisdictions and then will discuss why ComEd's proposal in this Docket is not alternative regulation at all, but instead a proposal for piecemeal recovery for isolated program costs on top of continuing traditional regulation.

Q. Please summarize the recommendations that are set forth in your testimony.

A. My testimony explains that ComEd has not proposed any comprehensive Alternative Rate Regulation Plan, or any plan that satisfies the criteria set forth in 220 ILCS 5/9-244. My testimony also explains why Rate ACEP is poor regulatory policy and should not be approved by the Illinois Commerce Commission ("ICC" or "Commission"). Rather than offering a proposal that could legitimately be described as "alternative regulation", ComEd's proposed Rate ACEP authorizes business-as-usual rate cases and piecemeal rider recovery of certain capital and operating expense costs between rate cases. Rate ACEP is more appropriately labeled a rider than an alternative regulation rate structure and can only produce rate increases to consumers and higher revenue for ComEd than would exist under traditional rate of return regulation.

Q. What information have you relied upon in formulating your recommendations?

A. I have relied upon ComEd's pre-filed testimony and exhibits in this Docket, as well as the Company's responses to data requests submitted by Staff, AG, CUB and other parties in this docket, as well as in ICC Docket 10-0467. I also have relied upon my prior experience with regulation of public utilities over the past 30 years, including significant experience with alternative forms of regulation for telephone and energy utilities. I have also reviewed and referenced the Alternative Rate Regulation statute, 220 ILCS 5/9-244, that was provided to me by AG counsel.

II. DEFINITION OF ALTERNATIVE REGULATION.

Q. How does traditional energy utility regulation compare to "alternative regulation" as that term is typically used for energy utilities?

A. Traditional regulation is designed to adjust utility rates and revenues, so as to provide a reasonable opportunity for recovery of the overall costs to provide regulated services, including an opportunity to earn a reasonable return on prudently invested capital. The existing energy utility regulatory framework in Illinois and most other states functions under this overall cost of service approach, through which utility revenues are periodically adjusted based upon a test year that systematically measures elements of the revenue requirement within a formally docketed "rate case" proceeding.

Alternative regulation, in contrast, seeks to replace periodic rate cases with a different process of regulation having a primary goal of achieving lower long-term energy prices for the benefit of ratepayers, through improved incentives for efficiency that become achievable under such alternative regulation. Alternatives to frequent and costly rate cases under alternative regulation may include rate case moratoria, price cap regulation, earnings monitoring and sharing arrangements or combinations of these approaches.

Q. Before elaborating about the differences between alternative regulation and traditional regulation, please review the general attributes of traditional energy utility rate regulation.

A. Traditional regulation of energy utilities involves the conduct of formal rate cases, in which the utility selects a test year and presents a calculation of its desired revenue requirement, including operating expenses (including depreciation and taxes) plus a rate of return applied to a rate base measure of invested capital. The key characteristics of traditional rate case regulation include:

- A **test year**, in which all of the components of the revenue requirement are holistically analyzed and quantified in a balanced and internally consistent manner with appropriate "matching" of costs and revenues.
- Utilization of regulatory lag as an **efficiency incentive**, by financially rewarding the utility for achieved cost reductions and punishing the utility when costs increase more rapidly than revenues between test years.
- Application of **regulatory rules** to the analysis of revenue requirement components, including prescribed adjustments, minimum filing requirements, and adherence to past rate orders and policies.

- A detailed **formal filing** with testimony and exhibits supportive of the asserted revenue requirement.
- Updated quantification of most or all elements of the revenue requirement, in a **holistic measurement** of changing revenue requirements, including studies of the current cost of capital,
- An opportunity for **prudence review** of management actions or inaction that may have contributed to unreasonable recorded costs.
- **Procedural provisions** for discovery and critical analysis of test year data submitted by the utility, and for litigation of disputed issues.
- **Comprehensive Review** of utility filings, discovery and submission of testimony and exhibits by Commission Staff and consumer intervenors such as the People of the State of Illinois.
- **Regulatory costs** to support these more formal procedures.

The fundamental basis for traditional utility regulation is that, in the absence of competitive markets to determine pricing for an essential public service, just and reasonable utility rates should be determined based primarily upon the utility's prudently incurred costs to provide such monopoly services.

Q. Does cost-based test-year regulation cause the public utility to be completely indifferent about its cost levels?

A. No. An important element of traditional test period regulation is the incentive created for management to control and reduce costs, so as to maximize the opportunity to actually earn at or above the authorized return level <u>between rate case test periods</u>. Traditional test year regulation is not continuous regulation, because prices established in a rate case are normally fixed for a period of years. Changes in actual costs or sales levels between rate cases can increase or decrease a utility's profit levels before such changes can be translated into revised prices after a "next" rate case. This passage of time between rate cases, commonly referred to as "regulatory lag," serves as an efficiency incentive and moderates the counter-incentive that results when prices are based upon costs to serve.

Another beneficial characteristic of traditional test year regulation is the intensive focus upon utility operations and costs within a formal proceeding in which Commission Staff and other interested parties can carefully examine or audit the components making up the revenue requirement. The potential for regulatory disallowance of excessive or imprudently incurred costs in such formal proceedings represents another form of efficiency incentive to management.

Q. In contrast to traditional test period regulation, what is "alternative regulation"?

A. Alternative regulation is, as the name implies, a departure from and replacement for sole reliance upon the traditional, cost-plus test year rate case regulation normally applied to energy utilities. Instead of continuing to process periodic rates cases, movement to alternative regulation ordinarily involves new regulatory processes that may include:

- A moratorium on rate cases for a defined period of time, to amplify the incentives arising from regulatory lag; and/or,
- A price cap upon the utility's rates, in place of rate cases, to permit any operational efficiency improvements during the term of such caps to be

retained for shareholders while protecting ratepayers from un-reviewed rate increases; and/or

- Reporting and monitoring of the utility's achieved level of earnings, with a formulistic sharing of earnings above or below targeted levels;, and/or,
- Specific regulatory mechanisms that adjust utility rates to reward or punish the utility based upon measured performance compared to targets or objectives.

The most common objective of alternative regulation is to improve the overall framework of regulation, by moving away from the historical "cost-plus" approach using traditional utility rate cases and toward new approaches that can provide potentially larger rewards for efficiency and punishments for inefficiency, while at the same time reducing the administrative costs of conducting rate cases. A successfully implemented alternative regulation framework should be designed to induce higher utility productivity in the long term, while eliminating or reducing the need for rate cases and ensuring that any benefits from improved overall efficiency are equitably shared between utility shareholders and ratepayers. In my experience, there is general consensus surrounding these broad goals for alternative regulation. The detailed specification of an alternative regulation plan, however, involves many complex issues and significant uncertainties surrounding future financial outcomes. Achieving a reasonable balance for all concerned stakeholders in the design of an alternative form of regulation is a difficult, but critical task.

Q. Have alternative forms of rate regulation been widely adopted for electric utilities by other state commissions?

A. No. Alternative price cap regulation or price deregulation is pervasive for telephone utilities. However, the majority of state commissions continue to practice traditional test year rate case regulation for regulated electric distribution utilities. I am aware of only a few state commissions that have adopted alternative rate regulation for electric utilities, as a replacement for frequent rate cases. For example, the State of California has its major electric utilities on a three year rate case cycle, with a rate adjustment mechanism ("RAM") providing for adjustments in authorized revenue levels for the intervening years between formal test years.[1] Hawaii recently authorized a similar three year rate case cycle with RAM formula revenue adjustments in the years between test years.[2] However, in both California and Hawaii traditional rate cases are planned for the electric utilities every three years to provide a formal review of revenue requirements based upon the cost of service. In Mississippi, the two largest electric utilities participate in a Performance Efficiency Plan ("PEP") tariff that provides for annual revenue adjustments based upon prescribed formula and the achieved returns of Entergy Mississippi and Mississippi Power Company.[3]

Q. Are you aware of more limited departures from traditional test year, cost-based rate case regulation of electric utilities, using approaches that are not <u>complete</u> replacements for rate cases and traditional regulation?

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[1] A general description of the three year general rate case ("GRC") cycle at the CPUC can be found at: http://www.dra.ca.gov/DRA/energy/grc/ with links to the documents filed in cases for the major electric utilities. Between rate cases, a revenue balancing account is used to decouple changes in sales volumes from revenue levels.

[2] The Hawaii PUC Order in Docket No. 2008-0274 is available at: http://dms.puc.hawaii.gov/dms/OpenDocServlet?RT=&document_id=91+3+ICM4+LSDB15+PC_DocketReport59+26+A1001001A10H31A95141A1326018+A10H31A95141A132601+14+1960

[3] See: http://www.mpus.ms.gov/utility/electric/electric.html

A. Yes. Most states employ non-traditional ratemaking to adjust utility rates for changes in the fuel expenses and/or purchased energy costs incurred by electric utilities, because such costs are often found to be very large and difficult to accurately quantify in rate case test years, are largely beyond the control of utility management, and are so volatile as to threaten the financial stability of the utility and its access to capital on reasonable terms if not subject to rate rider recovery. Certain other pass-through taxes and special types of costs, such as energy efficiency program costs or environmental remediation costs may be granted piecemeal rate adjustment treatment as a matter of legislative or regulatory policy. However, truly alternative regulation involves a much broader change in the framework of regulation, with a goal of improving efficiency incentives and striving to replace or greatly reduce the frequency of traditional cost-plus test year rate cases.

Q. What authority is relied upon by ComEd in its proposed Rate – Accelerated Customer Enhancements Pilot ("Rate ACEP")?

A. The Company's Verified Petition references Section 9-244 of the Illinois Public Utilitech Act (220 ILCS Act 5/9-244), asking for approval of an alternative regulation pilot plan to be implemented through approval of a proposed new tariff, designated Rate ACEP, as set forth in ComEd Exhibit 1.2.

Q. Does Section 9-244 envision a broad change in the framework of regulation, of the types you have described in this testimony?

A. I believe it does. Paragraph (a) of Section 9-244 states that, "Notwithstanding any of the ratemaking provisions of this Article IX or other Sections of this Act, or the Commission's rules that are deemed to require rate of return regulation, and except as provided in Article XVI, the Commission, upon petition by an electric or gas public utility, and after notice and hearing, may authorize for some or all of the regulated services of that utility, the implementation of one or more programs consisting of (i) alternatives to rate of return regulation, including but not limited to earnings sharing, rate moratoria, price caps or flexible rate options, or (ii) other regulatory mechanisms that reward or penalize the utility through the adjustment of rates based on utility performance." While I am not a lawyer, the plain language of this statute suggests that approaches involving earnings sharing, rate moratoria, price caps or flexible rate options, that are listed under subsection (i), contemplate changes to the entire framework of regulation in Illinois so as to move away from continued periodic rate cases.

Q. Does Section 9-244 also provide authority for the Commission to approve performance based ratemaking arrangements?

A. Yes. The second passage under sub-section (a) provides for "…other regulatory mechanisms that reward or penalize the utility through the adjustment of rates based on utility performance" and is less specific in defining the scope of alternative regulation plans. Sub-section (a) further mandates that under such a plan, "…the utility's performance shall be compared to standards established in the Commission order authorizing the implementation of the other regulatory mechanisms."

Q. How does ComEd propose to utilize Section 9-244 to change the regulatory framework in Illinois?

A. ComEd seeks advance Commission approval of certain projects and the budgeted spending on these projects, as well as a special tariff to provide separate recovery of incurred costs for such programs on a piecemeal basis outside of rate cases. The

Company's proposal seeks to bundle four discretionary spending initiatives; 1) an Electric Vehicle pilot program, 2) an Urban Underground Facilities Replacement initiative, 3) funding for Smart Grid investment upon Commission approval, and, 4) Low Income Assistance programs with approval of proposed Rate ACEP. Notably, ComEd does not seek modification of the traditional cost-based periodic rate case form of regulation that has long been practiced in this State.

Q. Does ComEd characterize its request as "alternative regulation"?

A. Yes. According to ComEd's Verified Petition at page 2, "Traditional test year ratemaking largely rests on the dual premises that utilities should make investment decisions subject to regulatory review after those investments are made, and that rates should be set and investments reviewed based on 'test year' snapshots of utility costs. The process is, by its very nature, both retrospective and litigious." According to ComEd, "The utility is at risk not only for operational performance, but also that its decisions will be second-guessed and cost recovery denied for investments made in good faith. That regulatory uncertainty discourages long term investment and planning, and potentially stifles or delays beneficial investments."

Under ComEd's proposal and its new Rate ACEP, Section 9-244 would be the vehicle used to create what is claimed to be, "…another model that can benefit customers, utilities, and the public in ways that are unlikely to be obtained under traditional regulation." ComEd asks for approval of what it has characterized as an "alternative regulation mechanism" in the form of Rate ACEP as well as advance approval of four programs that can benefit customers and be implemented through the alternative regulation tariff."[4]

Q. Would ComEd's proposal provide a significant movement toward alternative regulation in Illinois?

A. No. ComEd's proposal is <u>not</u> alternative regulation, but is instead little more than a repackaging of the Company's previously submitted Rider SMP,[5] again seeking to increase customers' rates on a piecemeal basis for recovery of specific investments and expenses for targeted programs.[6] ComEd has not proposed any new regulatory framework driven by changes in ComEd's overall financial performance, revised methods to determine revenue requirements, sharing of earnings or any other meaningful expansion of performance incentives. Rate ACEP is also not performance based ratemaking, as it would not attempt to measure the utility's performance against any overall cost-efficiency or service quality metrics or standards that could justify penalties or rewards of any consequence to the Company or its ratepayers. Most importantly, alternative regulation should include a meaningful alternative to the continuation of traditional rate cases that are contentious, expensive and provide only modest incentives for operational efficiency. The ComEd proposal relies on regular rate cases in addition to Rate ACEP and does not provide the benefit of reduced regulatory burdens.

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[4] Verified Petition, page 4 at paragraph 6.

[5] Piecemeal ratemaking for System Modernization Program costs was proposed by ComEd, along with Rider SMP, in the Company's 2007 Illinois rate case, Docket No. 07-0566.

[6] In Docket No. 07-0566, ComEd proposed Rider SMP to solicit advance ICC prudence determinations and then piecemeal rate recovery between rate cases for eight proposed "System Modernization Projects (SMPs)" that included expanded deployment of technologies such as those characterized as smart grid, including certain AMI and distribution automation investments.

III. COMED'S PROPOSAL AND RATE ACEP.

Q. Please describe the Company's proposal in this Docket.

A. ComEd proposes a "mechanism" with two principal components that are bundled together so that the benefits claimed from new programs are only offered upon Commission approval of special rate recovery outside of rate cases under Rate ACEP:

First, ComEd proposes a plan for <u>advance regulatory review and approval</u> of its "investment decisions" for four proposed discretionary spending programs, with "three of such projects approved in this docket and approval for the fourth project, Accelerated Smart Grid Deployment, after completion of the AMI Pilot, submission of the ISSGC report and conclusion of the Smart Grid policy docket."[7] The four project areas which ComEd proposes to include in the mechanism are:

1. Accelerated Urban Underground Facilities Reinvestment ("UUFR"),
2. Electric Vehicle pilot ("EV pilot"),
3. Low Income Assistance ("LIA"), and
4. Accelerated Smart Grid Deployment ("Smart Grid")

After receiving the proposed Commission pre-approvals, ComEd proposes to use the proposed new Rate ACEP to charge customers and recover certain defined incremental revenue requirements associated with implementing these programs outside of the normal rate case process. ComEd Ex. 1.2 is a 21-page proposed tariff that describes the complicated details of the "mechanism" as it would impact customers' rates. ComEd witness Ross Hemphill provides an overview of this plan in Section II of his testimony and describes the project components, the cost recovery Rate ACEP proposal, and regulatory review processes in greater detail in Section III.

Q. Is there a common theme associated with each of the four projects or programs that ComEd has selected for special recovery through Rate ACEP?

A. Yes. ComEd witness Hemphill characterizes the programs and costs selected by ComEd for Rate ACEP treatment as "discrete and discretionary;" expected to produce "substantial customer benefits" that justify incurring the costs; but asserts that they would not be undertaken in the absence of pre-approval by the Commission and piecemeal cost recovery through Rate ACEP. According to Mr. Hemphill, "Given the realities of test year ratemaking, ComEd's financial situation, and the demands being placed on ComEd's budgets that are functionally out of our control, ComEd cannot simply fund beneficial Smart Grid deployment, Urban Underground Facility Reinvestment, low-income assistance, or an EV pilot without regulatory guidance and a means to recovery our costs…"[8] Another theme is that these programs have the potential to create incremental societal benefits, such as improved service reliability (UURD and Smart Grid), reduced greenhouse gases (EV and Smart Grid) and low income support, which benefits do not necessarily create tangible financial payback on the amounts invested.

Q. Has ComEd provided any estimates of the incremental charges to customers that may result from Commission approval of its proposed programs, with implementation of Rider ACEP?

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[7] Id. paragraphs 12 and 16.

[8] ComEd Ex. 1.0, lines 159-161 and 181-185.

A. Yes. ComEd Exhibit 1.3 is an Illustrative Summary of the projected investment, O&M and Rate ACEP recovery amounts. Using these illustrative calculations and the underlying assumptions, ComEd customers would be charged from $4.4 million to $5.2 million per calendar quarter, beginning in the fourth quarter of 2011,with cumulative estimated charges through January of 2013 totaling $24.1 million.[9] However, these calculations are illustrative only and do not reflect any potential future expansion in the scope of the four programs offered at this time. In addition, the tariff provides for the possible addition of new programs that may be proposed by ComEd for Rate ACEP treatment in the future. Specifically, ComEd's Rate ACEP tariff is open ended, providing for future expansion to include, "…any new or modified accelerated customer enhancement program proposed by the Company and approved by the ICC."[10] The Company's proposal is that there be "continuing input by stakeholders" and that, "The commission will also hold formal biennial review proceedings, as long as the alternative regulation tariff remains in effect, to review, modify, and adapt the programs conducted under its auspices."[11]

Q. How would Rate ACEP work to translate actual incremental costs for the proposed projects into future rate increases to customers?

A. Formulae in proposed Rate ACEP would be used to calculate the incremental amounts due ComEd and update that calculation quarterly.[12] At Original Sheet X+5, a complex formula for the term ACEPA is presented, that would accumulate

[9] Actual timing would depend upon the timing of Commission approval of programs and ComEd's rate of actual spending. Charges through Rate ACEP would continue and grow until ComEd's next base rate case provides an opportunity to include the cumulative investments within test year approved utility rates.
[10] ComEd Ex. 1.2, Original Sheet No. X+4 and Original Sheet No. X+12 and 13.
[11] ComEd Ex. 1.0, lines 125-129.
[12] Id. Lines 242-425.

recoverable amounts referred to as “Assessment” values for each program, including separately calculated amounts for each customer class for:

- Low Income (term LIAA),
- Electric Vehicle pilot (term EVA),
- Underground Facilities (term UFA),
- Smart Meters (term SMA),
- Smart Meter Customer Applications (term SMCAA),
- Distribution Automation (term DAA) and,
- An open-ended Approved Program Assessment (term APA).

After accumulating all of the recovery charges for each of these programs and adjusting for incremental amounts of Rate ACEP recoveries that may prove to be uncollectible (term IDUF), the overall recoverable amount is divided by the number of bills expected to be issued in each customer class (term N).

Additional separate tariff pages are required, at Original Sheet No. X+6 through X+14 to define the complex equations needed to translate defined recoverable expenditures for each qualifying program into the assessment amounts includable in the overall calculation of on Original Sheet No. X+5.

Q. Are the calculations of the rate adjustments under proposed Rate ACEP simple and straightforward, such that administration of the tariff would not be burdensome?

A. No. Rate ACEP is very complex. For instance, specifying the rate elements and calculations for Rate ACEP requires many pages of densely written defined terms and formulae. Considerable additional work would be required for the Commission

Staff and/or intervenor representatives, to evaluate ComEd's accounting records and project cost isolation procedures, so as to ensure that only appropriately incurred incremental costs directly associated with the programs are included in the calculations and that these types of costs are not being recovered through ComEd's base rates.

IV. COMED'S RATE ACEP PROPOSAL WILL NOT RESULT IN LOWER RATES COMPARED TO TRADITIONAL REGULATION.

Q. Would approval of Rate ACEP allow for implementation of the programs being recommended by ComEd at "rates that are lower than would otherwise apply" as indicated by Mr. Hemphill?[13]

A. No. Rate ACEP can only produce rate increases to consumers and higher revenues for ComEd, than would exist without Rate ACEP.[14] ComEd witness Hemphill suggests that by charging customers for only 95 percent of the incremental O&M expenses for the programs (other than Low Income) through Rate ACEP, customers have somehow "saved" money relative to what they would have paid under traditional regulation.[15] For consumers to save, it would be necessary to assume that 100 percent of the same incremental O&M in each future year would be incrementally recoverable under traditional regulation between test years – which is

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13. Id. Lines 522-524, Lines 607-617.
14. ComEd Ex. 1.2 Rate ACEP terms for the dollar assessments for each program are based upon plant investment amounts associated with electric vehicles, underground facilities plant and smart meters, along with associated depreciation expenses and O&M expenses. These amounts and anticipated expenditures for low income assistance cannot, under any credible assumptions, be negative in amount. Therefore, Rate ACEP could only produce positive net charges to consumers, as illustrated in ComEd Ex. 1.3 and 1.4.
15. Id. Lines 608-613.

clearly not how traditional, test year regulation functions and is not realistic. [16] Even if it were true that customers' future rates will truly be lower with Rate ACEP than without it, I would support withdrawal of the proposed Rate ACEP so that the Company could retain the higher revenues ComEd witness Hemphill asserts would be produced under traditional regulation.

Q. Has the Company proposed any incentives within its Rate ACEP proposal that would ensure that only reasonable costs are recovered?

A. Not really. First it must be recognized that every dollar charged by ComEd under Rate ACEP would produce incremental revenue that is purely additive to revenues provided under traditional regulation. From this perspective, the only possible risk to ComEd would be if Rate ACEP could produce bill credits to customers -- which it clearly cannot do in its proposed form. Nevertheless, Mr. Hemphill describes what he refers to as a "Targeted Incentive Mechanism" in Section IIIC of his testimony,[17] but this so-called incentive is of little or no value either in reducing the always positive Rate ACEP charges to ratepayers, or in stimulating productivity within ComEd.

What ComEd calls an "incentive" with respect to capitalized project costs is merely Commission pre-approval of discretionary project budgets that are proposed by ComEd and then, if ComEd's total actual capital spending on the projects

[16] The strained logic required to support an assertion that Rate ACEP could produce lower customer rates is revealed in ComEd's Petition at page 10 with the statement, "Were ComEd to fund the same investments through traditional test year regulation – *e.g.*, by annually filing a future test year general rate case – customers would receive no 5% credit and the realization of savings would await the next rate case." Traditional regulation for ComEd has not involved annual rate cases or future test years, but if such an approach were assumed, it would not be possible for the Company to adjust rates on a piecemeal basis for only incremental program spending, because ComEd would need to also account for growth in accumulated depreciation and accumulated

exceeds the Company's own budget by more than five percent, the recovery of carrying costs under Rate ACEP in excess of 105 percent of budget may eventually be refunded to consumers.[18] This would never reduce ComEd revenues relative to traditional regulation, but would simply limit surcharges to customers to 105 percent of approved budgeted cost levels. Alternatively, if actual capital spending is less than the approved budget by more than five percent (actual costs less than 95% of budget), ComEd would be allowed to retain half the savings, effectively overcharging customers on a 50/50 basis for carrying costs on budgeted capitalized costs that were <u>not</u> incurred.[19] This so-called incentive would do little more than encourage ComEd to (1) overstate the budgeted costs presented to the Commission for approval and (2) constrain actual program expenditures, which are admittedly discretionary to start with, so as to ensure that budgets are met or beaten (to the potential detriment of ratepayers and benefit to the Company).

Q. Would ComEd expose itself to permanent disallowance of actual capital spending in excess of the ComEd-budgeted amounts in future rate cases under the proposed "targeted incentive" within Rate ACEP?

A. No. If and when ComEd's actual capitalized costs on Rate ACEP projects exceed 105 percent of the Company-proposed and Commission-approved budgeted level, the Company proposes that it first charge customers carrying costs through Rate ACEP at the 105 percent of budget level until the next rate case. ComEd would then have an opportunity to defend any cost overruns with "consideration given to

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deferred taxes, as well as reasonably anticipated load/sales growth, productivity gains and inflationary impacts upon all of its other costs.

17 Id. Lines 366-401.
18 Id. Lines 374-388.
19 Id. Lines 389-391.

the prudence and reasonableness of the expenditure in excess of the budget in ComEd's next general rate case."[20] This is not incentive regulation, but instead business as usual rate cases plus advance, piecemeal recovery of selected program costs between rate cases.

Q. Is there any meaningful incentive for efficiency within Rate ACEP, which might influence the level of actual O&M costs that would be recoverable under the mechanism?

A. No. Beyond the carrying costs recovery mentioned above, Rate ACEP also provides for incremental rate increases to customers to pay O&M expenses associated with the approved projects, at 95 percent of actual cost not to exceed budgeted amounts. Rate ACEP permits cost recovery, over and above test year authorized expenses, by charging customers for the discrete incremental program O&M costs through Rate ACEP. This also would be entirely incremental revenue that ComEd can only charge its customers through Rate ACEP by incurring incremental program O&M expenses beyond the O&M costs identified in the Company's pending rate case. Under traditional regulation, ComEd is not entitled to piecemeal recovery for these types of additive O&M expenses, so ComEd's attempt to characterize the Company's offered forbearance of the last five percent of such piecemeal recovery as an incentive or benefit to ratepayers is absurd. However, even this suggested five percent expense absorption "benefit" to ratepayers appears to be subject to a claw-back provision and the potential to charge consumers more than actual costs, as evidenced by Mr. Hemphill's statement, "Only

[20] Id. Lines 383-387.

if ComEd beats the O&M budget by more than the voluntary deduction credited to customers can it gain any additional O&M benefit."[21]

Q. All of the "targeted incentives" set forth in the Company's proposal are tied to the establishment of budgets for each program. Does the ComEd proposal encourage the Commission or its Staff to <u>independently</u> set the capital or O&M budgets and project specifications for each program, in a way that might compel the Company to perform against more challenging cost targets?

A. No. ComEd proposes that the Company will provide the "budgeted amounts" of O&M and capital costs for each element of the plan.[22]

Q. Are the Company's proposed incremental expenditures for the four programs mentioned in its Verified Application tied to Commission approval of Rate ACEP?

A. Yes. The Company's Verified Petition, at paragraph 6 states, "Together with the alternative regulation mechanism itself, ComEd offers four programs that can benefit customers and be implemented through the alternative regulation tariff." ComEd witness Mr. Hemphill explains that the proposed new UUFR and EV investments and any Smart Grid investments approved by the Commission in the future could commence and would be enabled by the Company's proposal to pay for

[21] Id. Lines 399-401. It is not entirely clear how O&M limits would actually be applied. According to ComEd's response to Data Request No. DTR 1.28, this quoted statement "…was inadvertently included in Mr. Hemphill's testimony, and will be corrected via subsequent errata. Under proposed Rate ACEP, if ComEd beats an O&M expense budget by more than the voluntary deduction credited to customers, customers receive the full benefit of such O&M expense reductions." When Staff asked ComEd to agree to tariff formulae to document the "Expense Limiter Component" and the "Expense Cap Component of the proposed tariff in Data Request Nos. DTR 2.05 and 2.06, the Company stated that these components, "cannot be presented in a single equation. The development of the Expense Limiter/Cap Component requires the use of IF/THEN logic in addition to the use of equations."

[22] ComEd responses to Data Request Nos. AG 1.09 and 1.10.

these projects through Rate ACEP.[23] He also states that the proposed Low Income Assistance Program would be "implemented through the alternative regulation proposal."[24]

Q. Is ComEd tying the four programs to Rate ACEP because of any inability to finance needed investments or to fund low income programs?

A. No. In its response to Data Request AG 1.08(a), the Company stated, "The issue is not whether ComEd can access capital markets. Rather, ComEd's financial condition affects its ability to make necessary investments at a reasonable cost of capital…Without Commission review and pre-approval of the capital and O&M budgets, as provided for in the alternative regulation plan, additional investment in discretionary AMI and smart grid projects would harm ComEd's financial position. In its present financial condition ComEd is unlikely to undertake discretionary investments in additional AMI or smart grid without alternative regulation."[25]

Q. Does this response mean that ComEd does not have access to capital markets to fund these projects on reasonable terms?

A. No. ComEd is clear that "the issue is not whether ComEd can access capital markets," and then goes on to assert that its financial position may be harmed without both Commission pre-approval and piecemeal rate increases to fund these discretionary projects. Under traditional regulation the Commission relies on a utility's access to the capital markets both to provide capital for needed investment and as a means to incorporate investors' judgments about reasonable investments.

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23 ComEd Ex. 1.0, Lines 241-280.

24 Id. Line 360.

25 A complete copy of ComEd's response to Data Request No. AG 1.08 is contained in AG Exhibit 1.3.

Effectively, ComEd is attempting to replace investors' judgment about whether a project is economically justified with Commission pre-approval when it may not be economically justified. The response also suggests that the Company is looking to ratepayers to provide a source of new revenues for projects that would otherwise not likely be approved in the Company's own internal capital budgeting process, as the Company itself admits when it asserts that these projects, if invested in under traditional regulation, "would harm ComEd's financial position."

Q. Does ComEd assert that Rate ACEP and the higher prices to ratepayers illustrated in ComEd Exhibit 1.3 are justified because this mechanism will create benefits to ratepayers?

A. Yes. In paragraph 5 of its Verified Petition, ComEd states that its plan and Rate ACEP will "benefit customers" because it:

- Funds accelerated urban underground facility reinvestment that will improve reliability and create jobs.
- Implements an important pilot of zero-emission electric vehicles for utility operations.
- Provides a means of funding continued assistance for low-income customers after the current statutory programs expire, and
- Provides a mechanism to move forward with cost-effective smart grid technologies after the AMI Pilot, ISSGC and Commission's policy docket are completed.

Mr. Hemphill states, "The approval of this alternative regulation plan will provide for more expeditious implementation of programs that can provide significant benefits to Illinois residents and businesses within and outside of ComEd's service territory. Certainly, if it can be demonstrated that specific programs yield significant positive net benefits to customers and the state economy, then a mechanism that facilitates quick implantation of such programs is highly beneficial in itself."[26] As I discuss in the next section, ComEd witness Hemphill's assertions about these alleged benefits have *not* been demonstrated.

V. STATUTORY REVIEW CRITERIA ARE NOT MET BY RATE ACEP.

Q. Have any review criteria been established for the Commission to use in evaluating alternative rate regulation proposals?

A. Yes. I am advised by AG counsel that Section 9-244 (b) contains very explicit review criteria for a proposed program of alternative regulation and that the Commission must find, based on the record, that <u>all</u> of the review criteria have been satisfied in order to approve such a program. Section 9-244(b) states:

> (b) The Commission shall approve the program if it finds, based on the record, that:
>
> (1) the program is likely to result in rates lower than otherwise would have been in effect under traditional rate of return regulation for the services covered by the program and that are consistent with the provisions of Section 9-241 of the Act; and
>
> (2) the program is likely to result in other substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program; and
>
> (3) the utility is in compliance with applicable Commission standards for reliability and implementation of the program is not likely to adversely affect service reliability; and
>
> (4) implementation of the program is not likely to result in deterioration of the utility's financial condition; and

[26] ComEd Ex. 1.0, Lines 515-522.

> (5) implementation of the program is not likely to adversely affect the development of competitive markets; and
>
> (6) the electric utility is in compliance with its obligation to offer delivery services pursuant to Article XVI; and
>
> (7) the program includes annual reporting requirements and other provisions that will enable the Commission to adequately monitor its implementation of the program; and
>
> (8) the program includes provisions for an equitable sharing of any net economic benefits between the utility and its customers to the extent the program is likely to result in such benefits.[27]

In this section of my testimony, I will address each of the eight listed review criteria in Section 9-244(b) and explain whether the Company's proposal meets each criterion.

Q. Does the Company's proposed Rate ACEP represent an alternative regulation program that, "…is likely to result in rates lower than otherwise would have been in effect under traditional regulation for the services covered by the program; and that are consistent with the provisions of Section 9-241 of the Act?"

A. No. As I described above, Rate ACEP can only produce higher rates to consumers and higher revenues for ComEd. Otherwise, this piecemeal rate adjustment mechanism would be of no incremental value to the Company in helping to fund the programs offered in connection with Rate ACEP. The Company's Exhibit 1.3 and 1.4 provide illustrative estimates of the revenue and customer impacts that may be expected to result from approval of the Company's plan, and the amounts shown therein all represent higher charges to customers rather than, "rates lower than otherwise would have been in effect under traditional regulation".

Q. Would approval of ComEd's proposed programs and Rate ACEP be likely to result in other substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program?

A. Aside from the Low Income Assistance program, ComEd has not demonstrated "other substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program."[28] The costs and benefits from the other three proposed programs can readily be addressed and realized under traditional regulation without Rate ACEP.

Q. What is the EV Pilot program and how could any benefits from such a program be realized under traditional regulation?

A. Through its Electric Vehicle Pilot program, the Company intends to deploy a limited number of vehicles in an effort to determine whether the anticipated benefits associated with EVs exceed the costs. According to ComEd witness Michael McMahan, "A number of new types of hybrid, plug-in hybrid, and all-electric vehicles for utility applications are becoming available on the market. However, we cannot prudently deploy them on a widespread basis without first piloting them."[29] Notably, in his rate case testimony in pending Docket No. 10-0467, Mr. McMahon addresses ComEd's fleet of approximately 3,300 vehicles, including various hybrids, biofuel and flex-fuel vehicles.[30] The 59 incremental vehicles proposed under the EV Pilot program represent replacement of less than two

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[27] 220 ILCS 5/9-244(b).
[28] 220 ILCS 5/9-244 (b)(2).
[29] ComEd Exhibit 2.0, lines 59-61.

percent of the entire fleet.[31] In the normal course of business, ComEd would expect to replace at least 150 to 200 vehicles annually, given its depreciation accrual rates of 11.59% for passenger cars, and ranges from 5.72% to 12.04% for various types of trucks.[32] There is nothing special about the EV pilot, as it could readily be absorbed into ComEd's routinely large need to deploy replacement vehicles each year. However, rather than simply integrating the proposed EV Pilot into normal vehicle replacements, Rate ACEP clearly envisions shifting all the up-front costs and risks of the Company's planned EV research project onto customers, even though any benefits from this pilot are far from certain.

Q. What is the UUFR program and how could any benefits from such a program be realized under traditional regulation?

A. Through the proposed Urban Underground Facility Reinvestment ("UUFR") program, ComEd seeks to accelerate and re-prioritize the process of testing and, where indicated by those tests, replacing underground mainline feeder cable as well as accelerated inspection, repair, rebuilding, or replacement of cable support hardware and manholes where necessary.[33] ComEd is not proposing a new program of testing and replacement of facilities, but rather is indicating a proposed discretionary expansion of an existing program. Present levels of expenditures for testing and replacement of these facilities occurs under ongoing normal operations

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[30] Docket No. 10-0467; ComEd Ex. 9.0 Rev. at 44-45.

[31] ComEd Ex. 2.0, page 5, shows the planned quantity of EV vehicles for the Pilot would include 45 plug-in cars, 8 cargo/service vehicles, 4 hybrid bucket trucks and 2 PHEV digger-derrick vehicles.

[32] ComEd's rate case filing in Docket No. 10-0467 includes disclosure of depreciation accrual rates under Part 285.305 (e)

[33] ComEd Exhibit 4.0, lines 32-38.

with a budget of about $2 million and $5 million per year, respectively.[34] In his rate case testimony in Docket No. 10-0467, ComEd witness Michael B. McMahan addresses capital investments more globally, including the repair of over 26,500 underground cable faults in 2008 and 2009. He also indicates a total cost for underground cable faults, emergent cable and equipment replacement work involving $95 million in capital costs and another $60.8 million in expenses.[35] The proposed expansion and acceleration of ComEd's UUFR program would devote an additional $45 million over 18 months for proactive maintenance and reconstruction.[36] Thus, the UUFR program is an expansion of existing work that is addressed in the pending rate case.

Benefits from UUFR to consumers are claimed in four areas: a) improved reliability, b) improved safety, c) meaningful job creation, and d) potential reduction in long-term costs. ComEd has historically approached this work using a reactive approach to cost-effectively meet service requirements[37]and according to ComEd witness Michelle Blaise, there is nothing improper or imprudent about the Company's approach to underground facilities maintenance.

Under these circumstances, there has been no showing by ComEd that existing urban underground facility maintenance practices or spending levels are inadequate or that customers should be made to fund more aggressive testing and replacement of such facilities in order to correct unreliable or unsafe conditions or cost effectively create new jobs. If a more pro-active maintenance policy was

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34 Id. lines 79-86.

35 ComEd Ex. 9.0 in Docket No. 10-0467, lines 724-735.

appropriate and cost justified, ComEd could have commenced such spending and proposed recovery for such investment in the context of its overall rate case revenue requirement, rather than a discrete Rate ACEP surcharge. Even if the Commission accepts Ms. Blaise's suggestion that paying for an accelerated level of investment provides some level of improved reliability, there is no specific information provided in the Company's filing identifying or quantifying any benefits, nor any showing that such benefits are not achievable under traditional regulation.

Q. Can the benefits of AMI meter installation and distribution automation, under a smart grid architecture, be realized under traditional regulation in Illinois?

A. Yes. Investment in Smart Grid technologies, including pilot deployment of AMI meters and customer applications and distribution system automation are under study in the Commission's Smart Grid Policy Docket, so decisions regarding whether benefits to customers can justify cost-effective widespread deployment of Smart Grid remain unanswered at this time. For now and even after the Smart Grid Policy Docket is concluded, ComEd can continue to invest in distribution automation as it has historically, where that investment is needed based on applying conventional technical criteria to the individual circumstance.[38] Customers can continue to enjoy the benefits of such cost-effective ongoing deployment under traditional regulation. In addition, the Commission is awaiting the results of ComEd's AMI pilot, due to be concluded mid-year 2011, and a report evaluating

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[36] ComEd Ex. 4.0, lines 112-120. Of this amount, about $30 million would be incremental capital expenditure and $15 million would be incremental O&M cost.

[37] Id. lines 181-182.

the pilot, scheduled to be released in the third quarter of 2011. It is inappropriate to require ratepayers to pay a Rate ACEP surcharge for new smart meters – or to design a special cost recovery mechanism for the meters – before the Commission and stakeholders have formally evaluated the results of the ratepayer-funded pilot.

Q. Do you dispute that the Company's proposed Low Income Assistance Program will produce substantial and identifiable benefits that would be realized by customers served under the program and that would not be realized in the absence of the program?

A. Continuation of ComEd's Low Income Assistance Programs will produce benefits, as discussed in detail in the Direct Testimony of Roger Colton.[39] However, as explained by Mr. Colton, there is no reason such programs could not be made available under traditional rate case regulation with funding by Exelon shareholders rather than ratepayers. The Company's attempt to link continuation of Low Income Assistance to approval of Rate ACEP is opportunistic and inappropriate, as there is nothing about program cost recovery that requires a separate rate adjustment mechanism. The costs of the proposed low income programs have historically been paid by Exelon, rather than by ComEd's consumers. The request to fund them through Rate ACEP is not unlike a rider mechanism. However, riders are typically used to recover utility expenses that are large or volatile, difficult to quantify and beyond the control of utility management. The low income program expenses, however, fit none of these criteria. Recovery of low income assistance program

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[38] ComEd Ex. 2.0, lines 143-148.

[39] Filed as AG Exhibit 5.0 in Docket No. 10-0467 and AG Exhibit 2.0 in this Docket.

costs should be resolved in ComEd's pending base rate case and not be the subject of additional, incremental charges through Rate ACEP.

Q. The third statutory criteria for approval of alternative rate regulation for ComEd is whether the utility is in compliance with applicable Commission standards for reliability and implementation of the program is not likely to adversely affect service reliability. Are you aware of any reliability issues with regard to ComEd's existing services or any concerns with respect to reliability that are raised by proposed Rate ACEP and the four programs bundled with Rate ACEP?

A. I am not aware of any ComEd non-compliance issues with respect to reliability and do not see that ComEd's EV, UUFR, smart grid or low income programs would negatively impact reliability.[40]

Q. Would implementation of Rate ACEP and the four spending initiatives bundled with Rate ACEP satisfy the criteria that implementation of the program is not likely to result in deterioration of the utility's financial condition?

A. Yes. The rate increases expected to result from Rate ACEP, if approved by the Commission, would improve the utility's financial condition and would not detrimentally impact it. Indeed, the Company's proposal is not an alternative regulation plan that would create any meaningful incentives toward efficiency or expose the utility to any significant earnings sharing or risk parameters that could

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[40] The Company's Verified Petition states at page 11, "ComEd is in compliance with applicable Commission standards for reliability" and "Implementing this proposal is not likely to adversely impact service reliability."

arise from a substantive form of alternative rate regulation plan that is apparently envisioned by this criterion.

Q. Would the Company's proposal be likely to adversely impact the development of competitive markets?

A. No. It only covers non-competitive services and plant.

Q. Is ComEd in compliance with its obligation to offer delivery services pursuant to Article XVI of the Public Utility Act?

A. I am not aware of any Article XVI non-compliance concerns with regard to the Company.[41]

Q. Does Rate ACEP provide for annual reporting requirements and other provisions that will enable the Commission to adequately monitor its implementation of the program?

A. ComEd's proposal would require the Commission to play, what is characterized as a "central role in determining the direction ComEd will take with future investments in Smart Grid technology, accelerated underground facility reinvestment, and EV, as well as low income assistance."[42] The Commission will, of course, need to decide whether it wants to provide the advance prudence determinations and piecemeal revenue increases that ComEd seeks in return for allowing this "central role" to the Commission. I would not characterize Commission review as a "central role" however, because the Commission's review is limited to the proposed projects and budgets offered by the Company and the constraints of the administrative process. I would point out, too, that the role of evaluating what and how much plant investment

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[41] ComEd has represented in its Verified Petition at page 12 that it has offered delivery services since 1999, and continues to offer such services.

should be made is historically the responsibility of utility management, who are in a much better position to evaluate the costs and benefits of discrete technology choices and plant investment optimization, as opposed to regulators who are unlikely to have in their possession all of the information personnel and other resources necessary to independently conduct such evaluations.

Q. Do Rate ACEP and the four bundled spending initiatives offered by ComEd include provisions for equitable sharing of any net economic benefits between the utility and its customers to the extent the program is likely to result in such benefits?

A. No. Rate ACEP is designed to provide full recovery, on a piecemeal basis, of all the incremental costs incurred by ComEd, except for five percent of O&M expenses for the EV pilot and UUFR programs, so long as ComEd contains its discretionary capital spending to within 105 percent of its own budgeted amounts. This is not equitable sharing, but rather an aggressive recovery of and conversion of discretionary costs into new revenues for ComEd. The EV program is a pilot, for which any economic benefits are uncertain and for which ComEd's proposal would shift costs and risks to ratepayers and away from shareholders. If the UUFR produces any net economic benefits, through reduced outages and outage response costs, the resulting cost savings would not be shared with ratepayers until they are captured within a future rate case test year. Mr. Colton explains in his testimony why recovery of low income assistance program costs from ratepayers is inequitable.

[42] ComEd Verified Petition at page 12.

VI. RATE ACEP IS PIECEMEAL REGULATION.

Q. In your testimony, you have characterized Rate ACEP as piecemeal regulation, rather than alternative regulation. Why is this characterization appropriate?

A. Rate ACEP is designed to translate isolated incremental capital investments and incremental O&M spending on certain ComEd programs into quarterly rate increases, without regard to whether the Company's overall revenue requirement as measured by comprehensive updates to rate base, operating income and the cost of capital would justify such rate increases. It is very possible that offsetting reductions in other costs incurred by ComEd are more than adequate to "pay for" the incremental spending that is proposed by the Company for its bundled Rate ACEP programs. The AG/CUB recommended revenue reduction in the pending Docket No. 10-0467 rate case, and the Staff's proposed revenue increase, that is much smaller than ComEd's asserted revenue requirement, suggests that changes in the Company's overall cost to provide delivery services has not changed much in relation to changes in normalized revenues.[43] This relative stability is an indication that ComEd is finding ways to manage the business and its costs through the current recession such that needed rate relief is either minimal or negative. There is certainly no indication of financial need for piecemeal revenue increases outside the normal rate case process under these circumstances.

Q. Has ComEd committed to any moratorium on future rate cases as part of its piecemeal proposal for alternative regulation?

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[43] AG/CUB is recommending an overall revenue reduction of $45.4 million in AG/CUB Ex. 1.3, while Staff's witnesses propose a revenue increase of $78.1 million, or about 3.8% of jurisdictional revenues, per Staff Ex. 1.0 at Schedule 1.01.

A. No. In fact, the Verified Petition at paragraph 15 points to the pending rate case and states, "Because this alternative regulation plan contemplates ComEd investing additional capital of up to $130 million and incurring additional O&M expenses of up to $65 million, it is necessarily conditioned on ComEd receiving approval of rates that give it a reasonable opportunity to recover its other delivery costs." Thus, it would seem that ComEd is seeking continuation of traditional rate cases with rate relief to provide sufficient recovery of its other costs as a condition of offering Rate ACEP, which would in turn grant additional piecemeal revenues on top of the Commission's ordered revenue requirement outcome in Docket No. 10-0467. There is no suggestion or commitment in the Company's evidence that approval of Rate ACEP would either delay or reduce the frequency of future general rate cases. In fact, in its response to Data Request AG 1.03, the Company states, "ComEd declines to speculate on whether approval of its proposed alternative regulation pilot will reduce the frequency, scope or size of the company's required future traditional rate case proceedings."

Q. Does Rate ACEP contemplate special piecemeal analysis by the Commission and advance approval of certain, but not all, of ComEd's investment decisions?

A. Yes. ComEd is asking the Commission to "review and approve all deployments and the corresponding capital and O&M budgets in advance" for the programs that would be funded through Rate ACEP and then "hold formal biennial review proceedings, as long as the alternative regulation tariff remains in effect, to review, modify, and adapt the programs conducted under its auspices."[44] This is in stark contrast to traditional regulation, where utility management is responsible and held accountable for the detailed analysis and daily decisions required to evaluate service quality and operational issues and then acquire and deploy the resources (staffing, contractors, capital investments) needed to provide reliable service at reasonable cost. It would be inappropriate, in my opinion, to approve a mechanism like Rate ACEP, where ComEd can propose isolated, specific projects or programs, then burden the Commission and its Staff with the planning and resource deployment responsibilities that are normally borne by utility management. Again, it is important to note that ComEd's Rate ACEP tariff is open ended, providing for future expansion to include, "…any new or modified accelerated customer enhancement program proposed by the Company and approved by the ICC."[45]

Q. If the Commission approved Rate ACEP, over the objections of the Attorney General, would it be reasonable to expect that ComEd and other Illinois utilities would seek advance Commission prudence determinations and piecemeal rate relief for any new programs that were under consideration by management?

A. Yes. The ability to increase customers' rates on a piecemeal basis outside of periodic traditional rates cases would represent, in my view, a profit maximizing opportunity that utility management would seek to exploit to the maximum extent possible in its fiduciary responsibility to shareholders. Creation of a regulatory protocol to request and receive advance prudence determinations from the

[44] ComEd Ex. 1.0, lines 126-129.

[45] ComEd Ex. 1.2, Original Sheet No. X+4 and Original Sheet No. X+12 and 13.

Commission on issues involving deployment of complex new technologies and/or large future expenditures would also be an irresistible opportunity to shift management responsibilities and business risks from shareholders to ratepayers.

Q. Has the Company demonstrated any financial need for Rate ACEP or for its proposed piecemeal form of alternative regulation?

A. No. While the Company clearly desires piecemeal rate increases to provide additional revenues in return for committing to the proposed programs of targeted future discretionary investment, it has not demonstrated:

- Any financial need for incremental revenues to be able to fund the subject investments, particularly given the pending rate case in Docket No. 10-0467.
- Any inability to continue to invest in electric vehicles under traditional regulation, to evaluate the feasibility and cost-effectiveness of such vehicles within its fleet operations.
- Any economic or operational justification for the proposed incremental investments in accelerated UUF replacement, by a showing that ratepayers will in fact be better off with the investments than without them.
- That ComEd is unable to provide Low Income Assistance, either with shareholder funding or through traditional rate case regulation if the Commission finds that ratepayers should become responsible for such costs.
- That the AMI Pilot program and the Commission smart grid policy review now underway will ultimately be found by the Commission to support

> accelerated deployment of Smart Grid investments, that cannot then be reasonably financed and recovered under traditional regulation.

Q. Are any of the costs proposed by ComEd for recovery through Rate ACEP at this time so large, volatile, or beyond the control of management or difficult to quantify in a test year as to justify special rate recovery outside of traditional rate cases?

A. No. The calculations within ComEd's Exhibit 1.3 illustrations show that the revenue requirement for which piecemeal recovery through Rate ACEP is proposed is not large or volatile, but instead is a fairly constant quarterly amount that is less than one percent of the Company's jurisdictional revenues in Illinois.[46] The fact that the proposed expenditures on the bundled programs would be made willingly by ComEd only upon approval of Rate ACEP indicates that the Company has the financial capacity to make these investments, but questions their necessity in the absence of preferential ratemaking.

Q. Why should ComEd's future investments for UUF replacement costs, new fleet vehicles, smart grid distribution automation and advanced metering be recovered through traditional rate case regulation, rather than through a separate piecemeal Rate ACEP approach?

A. Traditional rate case regulation requires consideration of <u>all</u> elements of the revenue requirement, including sales volumes, rate base elements, wage and benefit

[46] ComEd Schedule C-1, page 1 in pending Docket No. 01-0467 shows jurisdictional Total Operating Revenues at present rate levels of $2.04 billion in column (E) at Line 3. The estimated revenue requirement of about $5 million per quarter in ComEd Ex. 1.3 in this Docket No. 10-0527 is about $20 million per year, which is less than one percent of existing jurisdictional revenues of $2.04 billion.

expenses, non-labor expenses, taxes and depreciation/amortization, as well as the current cost of capital, all within an internally consistent or matched test year. Isolation of specific investments or programs for separate piecemeal rate changes, through mechanisms like the proposed Rate ACEP, distort the matching and tend to overstate revenue requirements.

Q. How do you know that Rate ACEP would create a mismatch in terms of ComEd's future revenue requirement?

A. In general, Rate ACEP does not account for any of the continuing growth in accumulated depreciation or accumulated deferred income taxes that are associated with existing electric Plant in Service ("Plant"). It is improper and unreasonable to adjust utility rates for only additions to Plant in Service, while ignoring the continuous recovery of existing Plant that ComEd collects through its approved rates.

More specifically, as mentioned above, including new investment in electric vehicles in Rate ACEP without accounting for the avoided capital cost of new vehicles that would have otherwise been acquired is another example of mismatched rate determination. With regard to the accelerated UUF replacement program, Rate ACEP would provide for recovery of a piecemeal return and depreciation as well as for O&M recovery on UUF activities, but would not account for either the avoided cost of the normal level of ongoing UUF replacement that is embedded in test year rate cases or for any prospective O&M savings that may result from the acceleration of UUF replacements and reduced outage response costs. Similar matching problems exist with the Smart Meter and Distribution

Automation elements of Rate ACEP,[47] where no accounting is proposed for the potentially large O&M savings that are enabled by smart meters or for any O&M savings that may result from more expansive distribution automation deployment.

Q. Given these facts and the Company's proposal, how do you respond to ComEd witness Hemphill's assertion that traditional regulation is inadequate to address the programs covered by Rate ACEP?

A. Mr. Hemphill's criticism that "test year ratemaking focuses on cost snapshots, rather than the entire life cycle of a project"[48] is not valid. ComEd controls the timing of its rate cases and the selection of historical or future test years in preparing such cases. With this control, utility management can take continuous snapshots and submit the resulting picture it chooses, either historical or prospective, that best illustrates its view of the current balance (or imbalance) between overall costs and overall revenues. What management cannot do under traditional regulation is submit only a part of the picture, showing the Commission only selected increasing costs, while ignoring declining costs or growing revenues elsewhere in the business. Instead, a matched and complete image of the overall revenue requirement is required. Taken as a whole, over extended periods of time, these periodic snapshots become a motion picture of changing costs and prices that provide an opportunity, but not a guarantee, for an efficiently managed utility to earn a reasonable return on investment.

I also reject the notion advanced by Mr. Hemphill that "The time frames involved with Smart Grid, for example, extend will beyond the outer limits of test

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[47] ComEd Ex. 1.2, at Original Sheets X+9 and X+11 provide for no accounting for any expense savings that may result from smart meters or distribution automation.

year ratemaking."[49] ComEd has been investing in Smart Grid for some time, both in terms of gradual distribution automation investments when they are cost effective and the AMI Pilot, for which costs have been included in the Company's filing in the pending rate case.[50] Most of these costs are capital investments that become part of ComEd's rate base, where a return on investment and depreciation expense will be includable in revenue requirements over the entire life of the capital assets as they are included in rate base. ComEd has not committed to abstain from filing future rate cases, so there are no "outer limits of test year ratemaking" as suggested by Mr. Hemphill and the Company can be expected to assert its actual capitalized costs to install Smart Grid components, for consideration and recovery in future rate cases.

VII. RATE ACEP DOES NOT CONSTITUTE AN IMPROVEMENT OVER TRADITIONAL REGULATION.

Q. If we assume that adoption of alternative regulation is intended to occur in a manner that improves upon the existing framework of regulation for the benefit of both ratepayers and shareholders, does ComEd's proposed Rate ACEP represent any improvement upon traditional regulation?

A. Rate ACEP would clearly benefit only ComEd shareholders, by shifting costs and risks associated with proposed future investments in EV, UUFR, Low Income assistance and Smart Grid to ratepayers. This one-sided proposal is not the win/win

[48] ComEd Ex. 1.0, Lines 164-168.

[49] Id.

[50] ComEd WPB-2.1a, page 17 in Docket No. 10-0467 indicates proposed inclusion of $17 million of AMI Pilot capital costs in rate base, plus $4.4 million of AMI Phase 0 Meter Install costs. At Schedule B-10, page 3, AMP regulatory assets of $7 million are added into the rate base. At WPC-2.10, various AMP

approach that should be created for ratepayers and shareholders under alternative regulation. All of the projects ComEd has bundled with its Rate ACEP proposal could be accomplished under traditional regulation without redefining the responsibilities of management and the commission or shifting costs and risks so dramatically away from shareholders.

Q. How is it possible for ComEd to investigate and carefully deploy new technologies into its electric delivery and business support systems without Rate ACEP?

A. ComEd could continue to evaluate and carefully deploy new technologies in the same manner it has incorporated technology into its business historically. New investments in technology would continue to be deployed as needed to provide safe and adequate service in a cost-effective manner. If new technology provided an opportunity to increase operational efficiency, recovery of its deployment costs could then be justified in a traditional rate case filing.

Q. Would approval of Rate ACEP serve to simplify or streamline regulation in Illinois, thereby reducing the costs of regulation?

A. No. A complicated series of filings, review processes and rate changes would result from approval of Rate ACEP, all in addition to the regular rate cases the Company files when it believes an adjustment to its overall revenue requirement is necessary. According to Mr. Hemphill's testimony, "…the proposal provides for continuing input by stakeholders and two levels of commission review. The Commission reviews and approves all deployments and the corresponding capital

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Pilot deferred debit and regulatory asset amounts are amortized into the revenue requirement in the test year.

and O&M budgets in advance. The Commission will also hold formal biennial review proceedings, as long as the alternative regulation tariff remains in effect, to review, modify, and adapt the programs conducted under its auspices."[51] In its responses to data requests AG 1.13, DLH 1.07 and DLH 6.02, ComEd listed and described the filings and procedures it envisions for administration of Rate ACEP. I have included as AG Exhibit 1.4 a copy of these responses to illustrate this complexity.

Moreover, as noted earlier in my testimony, there is no suggestion or commitment in the Company's evidence that approval of Rate ACEP would either delay or reduce the frequency of future general rate cases.

Q. Has ComEd already invested in electric vehicles that are included in the Company's rate base under consideration in pending Docket No. 10-0467?

A. Yes. According to the Company's response to data request JLH 1.10, ComEd has 10 Toyota Prius converted plug-in hybrid vehicles and 9 International/Eaton hybrid bucket trucks in its utility fleet. A copy of this response is included as AG Exhibit 1.5(excluding voluminous Attachment 1). Clearly, ComEd didn't require advance commission approval or a special piecemeal cost recovery tariff to invest in its 19 existing electric vehicles.

Q. Would ComEd's proposed investment in 59 additional plug-in electric vehicles result in avoided capital investments in more traditionally petroleum fueled vehicles?

A. Yes. The ComEd employees who are expected to drive the new vehicles can only use one vehicle at a time. It would be reasonable to expect that ComEd will avoid

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[51] ComEd Ex. 1.0, lines 125-129.

the purchase of 59 conventionally fueled vehicles if it elects to purchase more plug-in electric vehicles. According to the response to data request JLH 1.03(b), the vehicles in the pilot program will be used to replace older vehicles that are at the end of their useful life. Rate ACEP reveals its one-sided nature by increasing charges to consumers for the carrying costs on the new vehicles, with no accounting for ComEd's avoided investment in the 59 vehicles that would have otherwise been needed by the Company. ComEd Ex. 1.2 at Original Sheet X+7 indicates how a pretax return and depreciation on electric vehicle plant investment would be reduced by depreciation on old vehicles being retired, but no offset is provided for the avoided pretax return and depreciation on the new vehicles that would be required by ComEd but for the substitution of electric vehicles.

Q. Is approval of Rate ACEP required to ensure that any benefits of ComEd investments in distribution automation and other Smart Grid technologies are not lost?

A. No. ComEd continuously invests in its distribution system, including deployment of distribution automation technologies, and other smart grid investments, where they can be cost effectively integrated. In my testimony responsive to ComEd's Rider SMP proposal in Docket No. 07-0566 I referenced Company evidence in that proceeding in stating:

> The Company and other utilities have relied upon the deployment of technology to improve service and reduce expenses for many years. For example, ComEd witness Mr. Williams describes the Company s past deployment of SCADA technology, smart switches and mobile dispatch systems to improve service and reduce expenses. Mr. Mitchell describes the Company s use of aerial spacer cable, dielectric injection treatment of underground cables and other new technologies to improve distribution system performance. To my knowledge, the Company has not suffered any past disallowance of these or other

> technology investments when its rate base was calculated within rate case proceedings.[52]

I reject the assertion by Mr. Hemphill that ComEd requires approval of the Rate ACEP mechanism at this time in order to move forward with deployment of, "…up to $95 million in additional investments in distribution automation ("DA") and AMI if the Commission finds those investments to be cost-beneficial."[53] There has been no showing in this Docket No. 10-0527 that traditional regulation will not continue to offer ComEd a reasonable opportunity for cost-effective deployment of new technologies, as it has in the past.

Q. Is it reasonable to expect that, under continued traditional regulation, ComEd will continue to replace its urban underground facilities ("UUF") when necessary, in order to provide safe and adequate service on a cost-effective basis?

A. Yes. ComEd witness Ms. Blaise explain and illustrates in her testimony how UUF facilities are configured, tested, monitored and repaired or replaced as necessary. There is no indication in her testimony that existing activities or levels of investment are inadequate. In fact, she asserts that there is "nothing improper or imprudent about" the Company's approach.[54] The costs of ComEd's test year inspection, testing, repair and replacement of UUF facilities has been recognized in determination of the revenue requirement in pending Docket No. 10-0467 and, to my knowledge, none of these costs have been contested as imprudent or

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[52] AG/CUB Ex. MLB-1.0 in Docket No. 07-0566, page 37.
[53] ComEd Ex. 1.0, lines 273-280.

unreasonable. **Q. Would the handling of low income assistance programs improve if Rate ACEP were approved, relative to how such programs are treated under traditional regulation?**

A. No. AG witness Mr. Colton explains in his testimony in this Docket[55] and in the pending ComEd rate case why low income assistance programs should be continued and should be funded by shareholders, rather than ratepayers. I defer to his testimony and the Commission's decision on this matter of regulatory policy, but would note that this issue, once resolved, does not require piecemeal tariff treatment for implementation. If any ratepayer funding for low income assistance is deemed necessary by the Commission, the amounts involved should be included in the Company's rate case rather than Rate ACEP because such amounts are not large, volatile, difficult to quantify or beyond the control of management.

Q. Would approval of Rate ACEP cause the Commission to become involved in active management of the utility?

A. Yes. If Rate ACEP is approved, the Commission should expect to be pulled into a much more active role in the planning, capital and expense budgeting, resource prioritization and management oversight of numerous projects and programs that have historically been the province of utility management, and for which management has historically been held accountable. Acceptance of this new regulatory role requires Commission and Staff participation in the various filings, review proceedings, reconciliation proceedings and other activities so they can be, as explained by Mr. Hemphill, "fully informed of the progress of all of these

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[54] ComEd Ex. 4.0, Section II and line 97.

[55] AG Ex. 2.0

projects so that these reviews may be informed and efficient."[56] This more active role for the Commission and its Staff is apparently desired primarily to obtain support of ComEd's proposed budgets and cost recovery mechanism for the bundled programs offered with Rate ACEP, and any further programs ComEd may proposed to add later. There has been no showing by the Company that the Commission or concerned intervenors are staffed or equipped to engage in this sort of micro-management of ComEd resource planning and operations. The Rate ACEP proposal also shifts the risk of investment decision making onto the Commission (on behalf of ratepayers) rather than shareholders -- who provide the traditional source of needed capital for infrastructure investments and control the hiring of management to plan and oversee such investments.

Q. What do you mean when you state that the Rate ACEP proposal "shifts the risk" of investment decision making onto the Commission rather than shareholders"?

A. Under traditional regulation, utility management is responsible to utilize shareholder funding for new capital investments that are prudently planned and executed, resulting in new plant assets that are used and useful in providing service. Under monopoly regulation of utilities, the Commission fixes cost-based rates that are intended to serve as a proxy for pricing that would occur in a more competitive marketplace. The utility, like an unregulated business, must exercise business judgment about how and where to invest its resources to ensure safe, reliable, least-cost service for its customers. The Commission then reviews the utility's

[56] ComEd Ex. 1.0, lines 508-512.

investments and includes in the company's revenue requirement those investments that are deemed reasonable and useful to the business of delivering utility service.

But unregulated businesses in competitive markets cannot conscript their customers to advance money for discretionary investments that may or may not ultimately result in consumer benefits, which is what ComEd's proposed Rate ACEP does. The responsibility to plan and deploy new capital for investment is plainly the role of investors, shareholders and lenders. ComEd's Rate ACEP proposal instead shifts that burden on to the Commission and ratepayers.

Q. Does ComEd welcome full Commission involvement into management of its investment and spending decisions?

A. No. In its response to data request No AARP 1.05, ComEd objected to the question and then stated, "The Commission has authority to review ComEd's reliability and maintenance practices. It is ComEd's view that the Commission does not have unilateral authority to order ComEd to take the actions proposed in this Docket, nor to order ComEd to take actions the reasonable and prudent costs of which are not recoverable." This response makes clear that it seeks only limited Commission involvement in certain investment decisions of its own making. I would also point out that the notion that the Commission would "order ComEd to take actions the reasonable and prudent costs of which are not recoverable" is unlikely at best.

VIII. CONCLUSION AND RECOMMENDATION.

Q. What is your recommendation with regard to ComEd's proposed alternative regulation pilot that would be implemented through proposed Rate ACEP?

A. For all the reasons stated herein, I recommend that Rate ACEP be rejected by the Commission. The Company's proposal is not a viable plan for alternative rate regulation and will result in ratepayers paying more than they otherwise would under traditional test year regulation. Moreover, the proposal does not meet all of the criteria set forth in Section 9-244(b) that are required for approval of such a plan.

Q. Do you propose any modifications to Rate ACEP that would cause the program to satisfy the criteria in Section 9-244(b)?

A. No. Rate ACEP and the Company's proposed application of alternative regulation to only selected investment programs is hopelessly piecemeal and incapable of setting just and reasonable rates in place of traditional regulation. It is my recommendation that the Commission continue to apply traditional test year regulation to ComEd, recognizing the Company's overall actual costs incurred to provide services as part of a properly matched and internally consistent test year measurement of all elements of the Company's revenue requirement, rather than adjust customer rates based on piecemeal ratemaking, as Rate ACEP requires.

Q. Does this conclude your testimony at this time?

A. Yes.